



State of Rhode Island and Providence Plantations

Revenue & Caseload Estimating Conference

ROOM 306, STATE HOUSE, PROVIDENCE, RI 02903

November 12, 2004

To: The Honorable Donald L. Carcieri, Governor
The Honorable William J. Murphy, Speaker of the House
The Honorable Joseph A. Montalbano, President of the Senate

From: Michael O'Keefe, House Fiscal Advisor *Michael O'Keefe*
Rosemary Booth Gallogly, State Budget Officer *Rosemary Gallogly*
Russell C. Dannecker, Senate Fiscal Advisor *Russell C. Dannecker*

Subject: November 2004 Consensus Revenue Estimating Conference

Summary

The Revenue Estimating Conference concluded its deliberations November 10 in open public meetings to adopt the economic forecast and review and revise the enacted estimated revenues for FY 2005 and adopt the initial estimates for FY 2006. The Conference revised the FY 2005 upward \$22.9 million based on FY 2004 reported revenues compared to enacted estimates, collections trends through October, and the revised economic forecast.

The Conference estimated FY 2006 revenues of \$3,033.1 million, which are \$78.7 million more than the enacted estimate for FY 2005 and \$55.8 million more than the revised FY 2005 estimate. It does not include the hospital license fee of approximately \$58.6 million that is in the enacted FY 2005 estimate but which ends in FY 2005 under current law.

The estimates are based on current laws and include the first major estimates of the historic preservation tax credits. Tables showing the estimates and the changes are included at the end of this report.

Economic Forecast

On October 29th, economists David Pace of Global Insight and Steven Cochrane of Economy.Com presented Conferees with updated economic forecasts for the US and Rhode Island. Their testimony covered current economic performance and the outlook over the next several years and how the outlook changed since the May 2004 estimates. Robert J. Langlais,

Assistant Director, Labor Market Information, Department of Labor and Training reviewed and analyzed latest labor market data for the state.

After questioning the presenters and deliberating their forecasts, Conferees adopted the updated consensus forecast for Rhode Island shown below. The updated forecast made modest changes to the consensus outlook adopted at the May Conference.

National Economic Outlook.

Third quarter real gross domestic product will likely record a real growth rate of about 4 percent, significantly better than the second quarter pace, which had been hampered by soaring oil prices and a much deeper trade deficit. Looking ahead, both the third and fourth quarters are on a faster track, fueled by the return of robust business investment spending on plant and equipment, better car and truck sales, and strong housing-related and other construction activity.

Economic growth for calendar years 2004 and 2005 is expected to register somewhat slower growth than forecast at last May's Revenue Estimating Conference. The updated outlook for 2004 projects that stronger growth in the second-half should push up real GDP approximately 4.3 percent for the calendar year, significantly faster than the 3 percent for 2003. This is substantially slower than the 4.7 percent growth forecast at last May's Conference:

For calendar year 2005, the forecasters agree on a 3.3 percent pace for real GDP which is also significantly slower than the 2005 pace these forecasters had projected last May. Continued high oil/energy prices, weaker automotive sales, further tightening of monetary policy by the Federal Reserve, as they continue to hike interest rates over the period ahead, and the waning stimulus from the big federal tax cut will slow growth.

Turning to interest rates and inflation, the forecasters are in basic agreement that the Federal Reserve Board will continue the series of tightening moves begun last July. These actions have already raised the federal funds rate—from its multi-decade low of 1 percent to 1.75 percent currently. More increases in short term interest rates lie ahead and the forecasters generally agree that the fed funds rate will end this year at 2.00 percent and will be in the 3.25 to 3.50 percent range later in 2005. This results in an ascending pattern of short term interest rates that is modestly higher than that adopted as last May's Consensus forecast.

Lower oil prices ahead should keep inflation at bay, promising a reduction in inflation from 2.6 percent this year toward 1.9 percent in 2005 and beyond. The improving inflation trend should moderate the projected increase in longer-maturity bond rates, keeping the ascending pattern on essentially the same path that Conferees assumed last May.

Rhode Island Outlook

Since the state's recovery started back in November 2001, the road to higher employment has been neither fast nor straight. First out of the box among New England states, Rhode Island

resumed jobs growth in November 2001 when the level of employment bottomed out. The latest recession was far milder here than elsewhere, both regionally and nationally. The mildness of Rhode Island's recession is mainly attributed to the relative underexposure of the state to some key high tech sectors that were decimated since 2000. Rhode Island did not enjoy the economic thrust they had provided other nearby states during the nineties; but was also spared the damage done in their subsequent downfall.

Annual Growth	CY 2000	CY 2001	CY 2002	CY 2003	CY 2004	CY 2005	CY 2006
Nonfarm Employment (000's)	476.7	478.5	479.4	483.6	489.4	497.7	504.7
Nonfarm Employment Growth	2.4	0.4	0.2	0.9	1.2	1.7	1.4
Personal Income	7.5	5.0	2.9	3.7	4.4	4.2	4.0
Wage and Salaries Income	7.0	3.2	3.6	5.2	3.3	4.8	4.7
Farm Income	-71.4	-100.0	0.0	0.0	0.0	0.0	0.0
Nonfarm Business Income	10.1	23.6	0.0	7.9	7.6	6.3	5.4
Dividends, Interest and Rent	9.2	-0.1	-2.4	-2.3	3.5	1.0	2.0
Total Transfer Payments	4.1	11.5	5.3	3.2	5.0	4.2	4.0
Rates							
Unemployment Rate	4.1	4.7	5.1	5.3	5.3	5.2	5.0
Consumer Price Index (US)	3.4	2.8	1.6	2.3	2.6	1.9	1.7
Ten Year Treasuries	6.0	5.0	4.6	4.0	4.4	5.0	5.5
Three Month Treasuries	5.8	3.4	1.6	1.0	1.4	3.0	3.4

Annual Growth	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Nonfarm Employment	471.8	479.2	477.9	481.1	486.3	493.6	501.2
Nonfarm Employment Growth	2.3	1.6	-0.3	0.7	1.1	1.5	1.5
Personal Income	5.8	6.7	3.4	3.0	4.3	4.3	4.1
Wage and Salaries Income	6.4	5.4	2.6	4.4	4.6	4.1	4.8
Farm Income	-33.3	-75.0	-50.0	0.0	0.0	0.0	0.0
Nonfarm Business Income	5.4	18.9	9.6	2.7	9.5	7.0	5.9
Dividends, Interest and Rent	3.6	5.1	-1.6	-3.2	0.6	2.3	1.5
Total Transfer Payments	4.2	7.9	9.0	3.6	4.2	4.6	4.1
Rates							
Unemployment Rate	4.1	4.4	4.8	5.4	5.3	5.3	5.1
Consumer Price Index (US)	2.9	3.4	1.8	2.2	2.2	2.3	1.8
Ten Year Treasuries	6.2	5.4	5.0	4.0	4.3	4.7	5.3
Three Month Treasuries	5.4	5.3	2.2	1.3	1.0	2.2	3.2

For 2004, the state is expected to resume growth during the second half, benefiting from rising economic activity and personal income throughout the region. The Conferees reduced the growth rate in jobs to 1.2 percent for calendar 2004, somewhat slower than the 1.4 percent forecast adopted last May. Even with slower jobs growth, Conferees agreed with the forecasters to raise the outlook for personal income growth to 4.4 percent for this calendar year versus 3.8 percent adopted last May. This results in part from the substantial upward revision in the state's recent income trends by the US Bureau of Economic Analysis, whose September official revisions boosted 2003 wage and salary incomes substantially versus their earlier estimate for the year.

By 2005, Rhode Island's economy should be experiencing a solid, broad-based expansion. With economic activity bolstered by gains in both the consumer and business sectors of the economy,

Conferees agreed to assume 1.7 percent growth in total state jobs, the same pace adopted at last May's Conference. The table above shows the forecasts by calendar year and fiscal year.

Revenues

Taxes. FY 2005 revenues from taxes are estimated at \$2319.0 million, an increase of 6.5 percent over FY 2004 reported revenues from taxes. This is \$30.3 million more than the enacted estimates.

FY 2006 total estimated taxes are \$2,408.5 million, \$119.9 million more than the enacted FY 2005 estimate and \$89.6 million, or 3.9 percent, more than the revised FY 2005 estimate

Historic Preservation Tax Credit. Tax revenues also include major adjustments for the historic preservation tax credit, which came into effect for tax year 2002 with initial impacts seen in tax year 2003 filings received during FY 2004. The estimators worked from the \$148.8 million in credits estimated by the Historic Preservation and Heritage Commission on November 4 shown below. That \$148.8 million has grown \$13.9 million from the Commission's report this past April; it is likely to continue to grow.

Projects as of Nov 4, 2004	Completed	Active	Total
2002	\$ 3,908,695	\$ 87,900	\$ 3,996,595
2003	18,074,779	210,000	18,284,779
2004	2,357,916	24,616,804	26,974,720
2005		47,501,850	47,501,850
2006		27,864,000	27,864,000
2007		360,000	360,000
2008		23,784,000	23,784,000
2009		45,000	45,000
	\$ 24,341,391	\$ 124,469,554	\$ 148,810,944

The estimators then estimated the spread of these credits across the three tax sources where the Division of Taxation indicates they are currently being utilized in FY 2004 and FY 2005 to allocate the portion of the \$148.8 million that would occur during the period covered in the outyear forecasts. The conferees estimated \$38.0 million less in revenues between FY 2005 and FY 2006 due to the credits.

November 2004							
Estimate	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Income	\$ 1.17	\$ 12.00	\$ 12.00	\$ 21.00	\$ 20.00	\$ 9.00	\$ 9.00
Corporations	-	1.00	1.00	2.00	2.00	1.00	1.00
Insurance	3.10	6.00	6.00	11.00	9.00	5.00	5.00
Total	\$ 4.27	\$ 19.00	\$ 19.00	\$ 34.00	\$ 31.00	\$ 15.00	\$ 15.00

Personal Income Tax. The estimates of \$949.9 million for FY 2005 and \$999.2 million for FY 2006 represent growth rates of 6.6 percent and 5.2 percent respectively, and are \$23.6 million above the enacted estimate for FY 2005 and \$49.3 million for FY 2006. The estimates include \$12.0 million lost each year for the historic preservation credits. They also include slightly less revenue than anticipated from tax compliance and enforcement actions than included in the enacted estimate, which the estimators anticipate will still come to fruition in later years after processing issues are resolved.

Nov 2004 Consensus Estimates	FY 2004		FY 2005 Estimate		FY 2006 Estimate	
Personal Income Tax	\$ 890,917,958	9.5%	\$ 949,900,000	6.6%	\$ 999,200,000	5.2%
General Business Taxes						
Business Corporations	75,996,096	21.0%	86,000,000	13.2%	91,100,000	5.9%
Public Utilities Gross	88,689,212	16.5%	91,400,000	3.1%	92,400,000	1.1%
Financial Institutions	(7,296,194)	-174.4%	(1,100,000)	-84.9%	100,000	-109.1%
Insurance Companies	43,418,735	-15.3%	41,700,000	-4.0%	42,700,000	2.4%
Bank Deposits	1,579,935	-6.9%	1,600,000	1.3%	1,600,000	0.0%
Health Care Provider	40,317,507	43.3%	43,400,000	7.6%	44,100,000	1.6%
Sales and Use Taxes						
Sales and Use	826,640,919	6.3%	864,000,000	4.5%	904,200,000	4.7%
Motor Vehicle	47,481,034	0.5%	47,100,000	-0.8%	48,000,000	1.9%
Motor Fuel	877,113	-14.2%	850,000	-3.1%	875,000	2.9%
Cigarettes	117,418,114	24.4%	137,500,000	17.1%	126,100,000	-8.3%
Alcohol	10,342,162	2.8%	11,600,000	12.2%	12,100,000	4.3%
Controlled Substances	-	-	-	-	-	-
Other Taxes						
Inheritance and Gift	23,904,508	-1.8%	27,000,000	12.9%	27,500,000	1.9%
Racing and Athletics	4,939,874	0.0%	4,600,000	-6.9%	4,470,000	-2.8%
Realty Transfer	13,036,709	33.3%	13,400,000	2.8%	14,100,000	5.2%
Total Taxes	2,178,263,682	8.2%	2,318,950,000	6.5%	2,408,545,000	3.9%
Departmental Receipts	290,960,946	0.2%	297,000,000	2.1%	238,000,000	-19.9%
Gas Tax Transfer	8,398,244	-67.1%	9,560,000	13.8%	9,600,000	0.4%
Other Miscellaneous	65,617,418	-64.4%	16,799,000	-74.4%	8,466,000	-49.6%
Lottery	281,113,934	18.8%	318,000,000	13.1%	356,700,000	12.2%
Unclaimed Property	17,042,121	101.5%	17,000,000	-0.2%	11,800,000	-30.6%
Total General Revenues	\$ 2,841,396,345	3.1%	\$ 2,977,309,000	4.8%	\$ 3,033,111,000	1.9%

Business Taxes. The Conference estimates \$263.0 million in FY 2005 and \$272.0 million in FY 2006. Growth rates are 8.4 percent and 3.4 percent, respectively. The FY 2005 estimate is \$2.4 million more than the enacted estimate; but includes \$7.0 million of historic preservation tax credits that had not been anticipated in the enacted estimate. All business taxes except corporate income were revised upward

FY 2006 revenues are anticipated to be \$11.4 million more than the enacted FY 2005 estimate and \$9.0 million more than the revised estimate. These also include \$7.0 million of historic preservation tax credits.

Consumption Taxes. The Conferees adopted \$1,061.1 million for FY 2005 and \$1,091.3 million for FY 2006 from the consumption taxes, growth of 5.8 and 2.8 percent respectively. The FY 2005 revised estimate is \$42,000 less than enacted due to a \$6.3 million downward revision in cigarette taxes. The enacted estimate included a 75-cent per pack tax increase causing an estimated 88-cent per pack price increase. The impact on revenues appears to have been underestimated. The estimators project a further \$11.4 million decline in FY 2006.

The estimators revised the sales tax estimate upward by \$5.4 million to \$864.0 million for FY 2005, growth of 5.4 percent. They estimated \$904.2 million for FY 2006, 4.7 percent growth over the revised FY 2005 estimate. Sales tax would contribute 29.8 percent of all FY 2006 estimated revenues and 37.5 percent of tax revenues.

Other Taxes. The inheritance, racing and athletics, and realty transfer taxes are estimated to produce \$45.0 million in FY 2005 and \$46.1 million in FY 2006. The revised FY 2005 estimate is \$4.4 million above the enacted, 7.4 percent growth over FY 2005. FY 2006 revenues from these sources are estimated to grow 2.4 percent.

Other Sources. Other source revenue consists of departmental revenues, transfers to the general revenue fund from gas tax deposited in the transportation fund, the lottery, unclaimed property, and other miscellaneous sources. These are estimated to produce \$658.4 million in FY 2005 and \$624.6 million in FY 2006. The FY 2005 estimate is \$7.4 million less than previously estimated; the FY 2006 estimate is \$41.2 million less than enacted for FY 2005 due to the hospital license fee not included.

Departmental Receipts. The estimators adopted estimates of \$297.0 million in FY 2005 and \$238.0 million in FY 2006 for these sources that include licenses and fees, fines and penalties, sales and services, and miscellaneous departmental earnings deposited as general revenues. The FY 2005 estimate is \$6.5 million less than the enacted estimate mainly due to enhancement measures not being implemented.

FY 2006 drops off mainly due to the end of the hospital license fee in FY 2005, which produces \$58.6 million in FY 2005. That fee has been on a year-to-year basis, and has been extended each year since its inception. However, the estimators must estimate within current law, under which there would not be a fee in FY 2006.

Gas Tax Transfer. The estimators maintained the current estimate and increased the FY 2006 estimate very slightly. They estimated \$4.78 million per penny for FY 2005 and \$4.800 million for FY 2006. The transfers, under current law, are based on 2.00 cents.

Lottery is estimated to transfer \$318.0 million in FY 2005 and \$356.7 million in FY 2006. The FY 2005 estimate is a downward revision of \$4.4 million over the enacted estimate; the FY 2006 estimate is \$34.3 million more than the enacted FY 2005 estimate and \$34.3 million more than the revised estimate.

- **Games.** The Conference adopted \$63.0 million for FY 2005 based on \$247.4 million of sales representing a decline of 0.8 percent based on year to date experience. They estimate \$66.3 million for FY 2006 on \$260.3 million in sales based on the five-year average growth of 5.2 percent. The FY 2005 transfer of \$7.0 million less than the enacted estimate of \$70.0 million.

- **Video Lottery Terminals.** The Conference adopted \$255.0 million for FY 2005, which indicates 15.4 percent net terminal income growth to \$414.2 million. The estimated transfer is \$2.6 million more than the enacted estimate, reflecting sales to date greater than anticipated.

The Conference adopted \$290.4 million for FY 2006, based on 13.8 percent net terminal income growth to \$471.4 million. It does not include any expansion at Lincoln or Newport allowing space for any of the authorized 740 machines not yet placed. The estimators agreed that additional machines would not likely increase the estimate for FY 2006 due to lowered yields per machine per day. The impact would be felt in FY 2007.

Unclaimed Property. The Conference adopted \$17.0 million for FY 2005 and \$11.8 million for FY 2006, increases of \$5.9 million and \$1.7 million, respectively, to the enacted estimate.

Nov 2004 Consensus Estimates	FY 2005 Revised Estimate	Change to Enacted	FY 2006 Estimate	Change to Enacted
Personal Income Tax	\$ 949,900,000	\$ 23,624,714	\$ 999,200,000	\$ 72,924,714
General Business Taxes				
Business Corporations	86,000,000	(5,330,674)	91,100,000	(230,674)
Public Utilities Gross	91,400,000	4,900,000	92,400,000	5,900,000
Financial Institutions	(1,100,000)	1,900,000	100,000	3,100,000
Insurance Companies	41,700,000	700,000	42,700,000	1,700,000
Bank Deposits	1,600,000	590,000	1,600,000	590,000
Health Care Provider	43,400,000	(400,000)	44,100,000	300,000
Sales and Use Taxes				
Sales and Use	864,000,000	5,400,000	904,200,000	45,600,000
Motor Vehicle	47,100,000	-	48,000,000	900,000
Motor Fuel	850,000	(242,000)	875,000	(217,000)
Cigarettes	137,500,000	(6,300,000)	126,100,000	(17,700,000)
Alcohol	11,600,000	1,100,000	12,100,000	1,600,000
Controlled Substances	-	-	-	-
Other Taxes				
Inheritance and Gift	27,000,000	2,000,000	27,500,000	2,500,000
Racing and Athletics	4,600,000	(10,000)	4,470,000	(140,000)
Realty Transfer	13,400,000	2,400,000	14,100,000	3,100,000
Total Taxes	2,318,950,000	30,332,040	2,408,545,000	119,927,040
Departmental Receipts	297,000,000	(6,475,074)	238,000,000	(65,475,074)
Gas Tax Transfer	9,560,000	-	9,600,000	40,000
Other Miscellaneous	16,799,000	(2,374,000)	8,466,000	(10,707,000)
Lottery	318,000,000	(4,397,367)	356,700,000	34,302,633
Unclaimed Property	17,000,000	5,850,000	11,800,000	650,000
Total General Revenues	\$ 2,977,309,000	\$ 22,935,599	\$ 3,033,111,000	\$ 78,737,599

